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personnel management element of a firm's system
of quality control-- competencies required by a
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American Institute of Certified Public Accountants. Auditing Standards Board

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EXPOSURE DRAFT

PROPOSED STATEMENTS ON QUALITY CONTROL STANDARDS

**SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S
ACCOUNTING AND AUDITING PRACTICE (A REVISION OF
STATEMENT ON QUALITY CONTROL STANDARDS NO. 2,
*SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S
ACCOUNTING AND AUDITING PRACTICE*)**

and

**THE PERSONNEL MANAGEMENT ELEMENT OF A FIRM'S
SYSTEM OF QUALITY CONTROL –
COMPETENCIES REQUIRED BY A PRACTITIONER-IN-CHARGE
OF AN ATTEST ENGAGEMENT**

JUNE 17, 1999

**Prepared by the AICPA Auditing Standards Board for comment
from persons interested in auditing, reporting, and quality control matters**

**Comments should be received by August 17, 1999, and addressed to
David Brumeloe, Director, SEC Practice Section, File 2580
AICPA, Harborside Financial Center
201 Plaza Three, Jersey City, NJ 07311-3881 or dbrumeloe@aicpa.org**

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Any individual or organization may obtain one copy of this document without charge until the end of the comment period by writing to the AICPA Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881. This document is also available on AICPA Online at <http://www.aicpa.org>.

June 17, 1999

Accompanying this letter are exposure drafts, approved by the Auditing Standards Board (ASB), of two proposed Statements on Quality Control Standards (SQCSs) entitled *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, a revision to SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 20), and *The Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-In-Charge of an Attest Engagement*. The first proposed Statement revises SQCS No. 2, Section QC 20.18 of the engagement performance element of quality control to require, where applicable, that a firm's quality control policies and procedures address the AICPA's SEC Practice Section's membership requirement that mandates concurring partner reviews of all SEC registrants. The Appendix to this exposure draft presents SQCS No. 2, as proposed to be revised by this Exposure Draft. The second proposed Statement expands the personnel management element of quality control to incorporate a requirement for a firm to adopt quality control policies and procedures that provide a firm with reasonable assurance that individuals who assume responsibility for signing attest reports meet certain minimum competencies. A summary of the significant provisions of the proposed Statements accompanies this letter.

Comments or suggestions to the proposed revision of QC Section 20.18 of SQCS No. 2 will be appreciated. Comments or suggestions on any aspect of the second exposure draft are welcomed. To facilitate the ASB's consideration of responses, comments to the exposure drafts should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

In developing guidance, the ASB considers the relationship between the cost imposed and the benefits reasonably expected to be derived from the requirements of a quality control standard, including how the requirements affect small CPA firms. When appropriate, the ASB makes special provisions to meet those needs. Thus, the ASB would particularly appreciate comments on those matters.

Written comments on the exposure drafts will become part of the public record of the AICPA Auditing Standards Division and will be available for public inspection at the offices of the AICPA after December 17, 1999, for one year. Responses should be sent to David Brumbeloe, Director, SEC Practice Section, File 2580, AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881 or dbrumbeloe@aicpa.org, in time to be received by August 17, 1999.

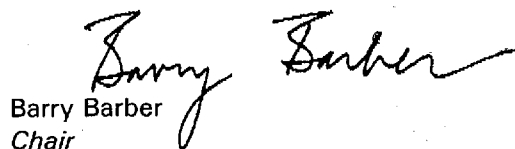
Sincerely,



Deborah D. Lambert
Chair
Auditing Standards Board



Arleen R. Thomas
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Tom Ray
Director
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SUMMARY

Why Issued

The Auditing Standards Board (ASB) is considering the issuance of two Statements on Quality Control Standards (SQCSs) to provide a CPA firm with improved guidance for establishing and maintaining a quality control system for its accounting and auditing practice.

Proposed Statement of Quality Control Standard, System of Quality Control for a CPA Firm's Accounting and Auditing Practice (A Revision of SQCS No. 2)

In recent years, the Securities and Exchange Commission (SEC) has successfully brought enforcement actions against individuals who, in the SEC's opinion, did not apply professional standards in his or her role as the concurring partner reviewer on SEC engagements. A task force established by the SEC Practice Section observed that professional standards do not discuss the role of the concurring partner reviewer and recommends that a revision be made to the quality control standards to require a firm to address in its quality control policies and procedures, if applicable, the SEC Practice Section membership requirement for concurring partner reviews on SEC engagements. To assist individuals who wish to comment on the proposed Statement the SEC Practice Section has provided, on its webpage, the concurring partner review membership requirement and related appendix. The Website address of the SEC Practice Section is <http://www.aicpa.org/members/div/secps/index.htm>.

Proposed Statement on Quality Control Standard, the Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement

The Uniform Accountancy Act (UAA), a model legislative statute and related administrated rules issued by a joint task force of the AICPA and the National Association of State Boards of Accountancy (NASBA), provides certain requirements concerning licensees in public practice that supervise attest services or signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm to meet certain experience requirements as required by professional standards. Thus, the issuance of the UAA resulted in consideration of the best method to address this particular requirement of the UAA in professional standards. This in turn resulted in a reconsideration of the Personnel Management element of quality control. A firm would be required to adopt quality control policies and procedures to provide the firm with reasonable assurance that individuals who are responsible for supervising accounting, auditing, and attest engagements and signing or authorizing an individual to sign the accountants report on such engagements meet certain minimum competencies.

The Joint Task Force on Quality Control Standards has recommended revisions to the Guide, *Quality Control Policies and Procedures for CPA Firms: Establishing Quality Control Policies and Procedures*, to provide guidance to firms on implementing and monitoring the requirements outlined in the proposed Statement. The ASB anticipates approving the revised Guide concurrently with the adoption of this proposed Statement and has provided excerpts of the Guide on its Web site to assist individuals who wish to comment on the proposed Statement. The Web site address of the ASB is <http://www.aicpa.org/members/div/auditstd>.

The proposed standards have been developed based on the recommendations of the Joint Task Force on Quality Control Standards, which was formed to develop general guidance for a system of quality control. In addition to ASB representation, the task force is composed of representatives from the SEC Practice Section Peer Review Committee and the AICPA

Peer Review Board. The task force wishes to acknowledge the contributions of its observers from NASBA and the Public Oversight Board.

The SEC Practice Section Peer Review Committee and the AICPA Peer Review Board have reviewed the exposure drafts and have advised the ASB that, although modifications may need to be made to their peer review programs, these modifications are not expected to result in an expansion of peer review to services provided beyond a firm's accounting and auditing practice.

What They Do

Proposed Statement on Quality Control Standards, System of Quality Control for a CPA Firm's Accounting and Auditing Practice (a Revision of SQCS No. 2)

This proposed Statement revises the Engagement Performance element of quality control and will require a firm to establish policies and procedures, if applicable, to address the SEC Practice Section's membership requirement for concurring partner review on SEC engagements. This revision will now provide a link to professional standards and the membership requirement of the SEC Practice Section.

Proposed Statement on Quality Control Standards, the Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement

This proposed Statement establishes a requirement for a firm to adopt quality control policies and procedures to provide reasonable assurance that individuals responsible for signing attest reports meet certain competencies. The proposed standard focuses on competencies that an individual would be expected to possess for certain kinds of attest engagements. The concept of competency is consistent with the existing Personnel Management element of quality control, which among other matters, requires that "those hired possess the appropriate characteristics to enable them to perform competently" and "work is assigned to personnel having the degree of technical training and proficiency required in the circumstances."

How They Affect Existing Standards

These proposed Statements would amend QC Section 20.18 of SQCS No. 2 and provide additional guidance to firms about adoption of policies and procedures relating to the personnel management element of quality control. Issuance of the proposed Statements would also require the adoption of amendments to the Guide *Quality Control Policies and Procedures for CPA Firms: Establishing Quality Control Policies and Procedures* (the Guide), to be updated. As a result of the issuance of these Statements and updating the Guide, firms with well-established quality control systems should not have to make significant modifications to their policies and procedures.

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PROPOSED STATEMENT ON QUALITY CONTROL STANDARDS

SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S ACCOUNTING AND AUDITING PRACTICE (A REVISION OF STATEMENT ON QUALITY CONTROL STANDARD NO. 2)

INTRODUCTION AND APPLICABILITY

1. This Statement revises QC Section 20.18 of Statement of Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, (AICPA Professional Standards, vol. 2, QC sec. 20), to require, where applicable, that a firm's quality control policies and procedures address the AICPA's SEC Practice Section's membership requirement that mandates concurring partner reviews on all SEC registrants.

AMENDMENT TO QC SECTION 20.18 OF SQCS NO. 2

2. QC Section 20.18 of SQCS No. 2 is amended by adding the sentence set in bold-face.

18. Policies and procedures for Engagement Performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. **Where applicable, these policies and procedures should also address the concurring partner review requirements applicable to SEC engagements as set forth in membership requirements of the SEC Practice Section of the AICPA.**

EFFECTIVE DATE

3. The amendment to paragraph QC 20.18 promulgated by the proposed Statement is applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2000.

PROPOSED STATEMENT ON QUALITY CONTROL STANDARDS

THE PERSONNEL MANAGEMENT ELEMENT OF A FIRM'S SYSTEM OF QUALITY CONTROL—COMPETENCIES REQUIRED BY A PRACTITIONER-IN-CHARGE OF AN ATTEST ENGAGEMENT

INTRODUCTION

1. Statement on Quality Control Standards (SQCS) No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (AICPA *Professional Standards*, vol. 2, QC sec. 20), provides that a CPA firm shall have a system of quality control for its accounting and auditing practice¹ that should encompass the following elements:

- a. Independence, integrity, and objectivity
- b. Personnel management
- c. Acceptance and continuance of clients and engagements
- d. Engagement performance
- e. Monitoring

THE PERSONNEL MANAGEMENT ELEMENT OF QUALITY CONTROL

2. *Personnel Management* encompasses hiring, assigning personnel to engagements, professional development, and advancement activities. Accordingly, policies and procedures should be established to provide the firm with reasonable assurance that—

- a. Those hired possess the appropriate characteristics to enable them to perform competently.
- b. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.
- c. Personnel participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies.²
- d. Personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

3. This Statement clarifies the requirements of the personnel management element of a firm's system of quality control. In light of the significant responsibilities during the planning and performance of accounting, auditing, and attest engagements of personnel who are re-

¹ *Accounting and auditing practice* refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA *Professional Standards*, vol. 2, ET sec. 201 and 202). Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

² Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

sponsible for supervising accounting, auditing, and attest engagements and signing or authorizing an individual to sign the accountants report on such engagements, a firm's policies and procedures related to the items noted in paragraph 2 above should be designed to provide a firm with reasonable assurance that such individuals possess the kinds of competencies that are appropriate given the circumstances of individual client engagements. For purposes of this standard, such personnel are referred to as the practitioner-in-charge of the engagement.

COMPETENCIES

4. Competencies are the knowledge, skills, and abilities that enable a practitioner-in-charge to be qualified to perform an accounting and auditing engagement. A firm is expected to determine the kinds of competencies that are necessary in the individual circumstances. Competencies are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by a practitioner in any given time period. Accordingly, for purposes of this Statement, a measure of overall competency is qualitative rather than quantitative.

Gaining Competencies

5. A firm's policies and procedures would ordinarily require a practitioner-in-charge of an engagement to gain the necessary competencies through practical accounting and auditing experience. In some cases, however, a practitioner will have obtained the necessary competencies through disciplines other than the practice of public accounting, such as in relevant industry, governmental, and academic positions. If necessary, the experience of the practitioner-in-charge should be supplemented by continuing professional education (CPE) and consultation. The following are examples.

- A practitioner-in-charge of an engagement whose practical experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE and by consulting, as necessary, with other practitioners with experience in performing similar accounting and auditing engagements.
- A practitioner-in-charge of an engagement who did not have any experience in auditing the financial statements of a public company and only possessed prior experience in auditing the financial statements of nonpublic entities may develop the necessary competencies by obtaining relevant CPE related to SEC rules and regulations and consulting with other practitioners who possess relevant knowledge related to SEC rules and regulations.
- A practitioner-in-charge of an engagement who did not have any experience in auditing the financial statements of a public company but possessed prior public accounting practice experience auditing financial statements of nonpublic entities and who also has relevant experience as the controller of a public company may have the necessary competencies in the circumstances.

6. Regardless of the manner in which a particular competency is gained, a firm's quality control policies and procedures should be adequate to provide reasonable assurance that a practitioner-in-charge of an engagement possesses the competencies necessary to fulfill his or her engagement responsibilities.

7. The nature and extent of competencies established by a firm that are expected of the practitioner-in-charge of an engagement should be based on the characteristics of a par-

ticular client, industry, and the kind of service being provided. For example, the following should be considered.

- The competencies expected of a practitioner-in-charge of an engagement to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
- Supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than what would be expected in performing attest services for clients in other industries.
- The practitioner-in-charge of an engagement to audit the financial statements of a public company would be expected to have certain technical proficiency in SEC reporting requirements, while a practitioner-in-charge who is not assigned to the audits of public companies would not need to be proficient in this area.
- The practitioner-in-charge of an attestation engagement to examine management's assertion about the effectiveness of an entity's internal control over financial reporting would be expected to have certain technical proficiency in understanding and evaluating the effectiveness of controls, while a practitioner-in-charge of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

Competencies Expected in Performing Accounting and Auditing Engagements

8. In practice, the kinds of competency requirements that a firm should establish for the practitioner-in-charge of an engagement are necessarily broad and varied in both their nature and number. However, the firm's quality control policies and procedures should ordinarily address the following competencies for the practitioner-in-charge of an engagement. Firms policies and procedures should also address other competencies as necessary in the circumstances.

- Understanding of the Role of a System of Quality Control and the Code of Professional Conduct*—Practitioners-in-charge of an engagement should possess an understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of accountant's reports.
- Understanding of the Service to be Performed*—Practitioners-in-charge of an engagement should possess an understanding of the performance, supervision, and reporting aspects of the engagement, which is normally gained through actual participation in that kind of engagement.
- Technical Proficiency*—Practitioners-in-charge of an engagement should possess an understanding of the applicable accounting, auditing, and attest professional standards including those standards directly related to the industry in which a client operates and the kinds of transactions in which a client engages.
- Familiarity with the Industry*—To the extent required by professional standards applicable to the kind of service being performed, practitioners-in-charge of an engagement should possess an understanding of the industry in which a client operates. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry specific estimates.

- e. *Professional Judgment*—Practitioners-in-charge of an engagement should possess skills that indicate sound professional judgment. In performing an audit or review of financial statements, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report necessary in the circumstances.

Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control

9. The competencies listed above are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

10. In establishing policies and procedures related to the nature of competencies needed by the practitioner-in-charge of an engagement, a firm may need to consider the requirements of policies and procedures established for other elements of quality control. For example, a firm would consider its requirements related to engagement performance in determining the nature of any competency requirements that assess the degree of technical proficiency necessary in a given set of circumstances.

THE RELATIONSHIP OF THE EXPERIENCE REQUIREMENT OF THE UNIFORM ACCOUNTANCY ACT TO THE PERSONNEL MANAGEMENT ELEMENT OF QUALITY CONTROL

11. The Uniform Accountancy Act (UAA) is a model legislative statute and related administrative rules that the AICPA and the National Association of State Boards of Accountancy (NASBA) designed to provide a uniform approach to the regulation of the accounting profession. CPAs are not required to follow the provisions of the UAA itself but rather the accountancy laws of the individual licensing jurisdictions in the United States governing the practice of public accounting, which may have adopted the UAA in whole or in part. The UAA provides that the "licensee who is responsible for supervising attest services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm shall meet the experience requirements set out in the professional standards for such services." A firm's compliance with this Statement is intended to enable a practitioner who performs the services described in the preceding sentence on the firm's behalf to meet this experience requirement; however, this Statement's applicability is broader than what is required by the UAA since the definition of an accounting and auditing practice in quality control standards encompasses a wider range of attest engagements.³

EFFECTIVE DATE

12. The provisions of this Statement are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2000.

³ Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

APPENDIX

SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S ACCOUNTING AND AUDITING PRACTICE

(Incorporating changes included in the Exposure Draft of Proposed Statement on Quality Control Standards—System of Quality Control for a CPA Firm's Accounting and Auditing Practice (A Revision of Statement on Quality Control Standards No. 2)

INTRODUCTION AND APPLICABILITY

1. This Statement provides that a CPA firm shall have a system of quality control for its accounting and auditing practice and describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system.
2. The AICPA Principles of Professional Conduct provide, among other things, that "members should practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised."¹ Because of the public interest in the services provided by and the reliance placed on the objectivity and integrity of CPAs, this Statement provides that a CPA firm shall have a system of quality control for its accounting and auditing practice.²

SYSTEM OF QUALITY CONTROL

3. A firm³ has a responsibility to ensure its personnel⁴ comply with professional standards applicable to its accounting and auditing practice. A *system of quality control* is broadly defined as a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality. The policies and procedures designed to implement the system in one segment of a firm's practice may be the same as, different from, or interrelated with the policies and procedures designed for another segment, but the purpose of the system is the same of all segments of a firm's practice.
4. A firm's system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of complying with professional standards. The nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its person-

¹ AICPA Code of Professional Conduct, "Article—VI—Scope and Nature of Services" (AICPA, *Professional Standards*, vol. 2, ET sec. 57.03).

² *Accounting and auditing practice* refers to all audit, attest, accounting and review, and other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under rule 201 or 202 of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET secs. 201 and 202). Standards may also be established by other AICPA senior technical committees; engagements that are performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.

³ A *firm* is defined in the AICPA Code of Professional Conduct as a "form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof" (AICPA *Professional Standards*, vol. 2, ET sec. 92.05).

⁴ The term *personnel* refers to all individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

nel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

5. Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in an individual's performance and understanding of (a) professional requirements or (b) the firm's quality control policies and procedures affects the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

6. The system of quality control should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States if such standards are applicable.

QUALITY CONTROL POLICIES AND PROCEDURES

Elements of Quality Control

7. The quality control policies and procedures applicable to a firm's accounting and auditing practice should encompass the following elements:

- a. Independence, integrity, and objectivity
- b. Personnel management
- c. Acceptance and continuance of clients and engagements
- d. Engagement performance
- e. Monitoring

8. The elements of quality control are interrelated. For example, the maintenance of *integrity*, *objectivity*, and, if required, *independence* requires a continuing assessment of client relationships. Similarly, the element of *personnel management* encompasses criteria for professional development, hiring, advancement, and assignment of the firm's personnel to engagements, which affect policies and procedures developed to meet the objectives of the quality control element of *engagement performance*. Similarly, policies and procedures for the quality control element of *monitoring* are established to provide the firm with reasonable assurance that the policies and procedures related to each of the other elements of quality control are suitably designed and are being effectively applied.

Independence, Integrity, and Objectivity

9. Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and in appearance) in all required circumstances,⁵ perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.

10. *Independence, integrity, and objectivity* are defined and more fully described in the AICPA Code of Professional Conduct (the Code) and "Independence," (AICPA *Professional*

⁵ Independence requirements are set forth in rule 101 of the AICPA Code of Professional Conduct, Statements issued by the Independence Standards Board, and the rules of applicable regulatory agencies such as state boards of accountancy, the Securities and Exchange Commission, the U.S. General Accounting Office, and the U.S. Department of Labor.

Standards, vol. 1, AU sec. 220). Rules 101 and 102 of the Code, and the related Interpretations and rulings (AICPA *Professional Standards*, vol. 2, ET secs. 101, 102, and 191) contain examples of instances wherein a member's independence, integrity, and objectivity will be considered to be impaired. *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to management and owners of a business but also to those who may otherwise use the firm's report. The firm and its personnel must be free from any obligation to or interest in the client, its management, or its owners.⁶ *Integrity* requires personnel to be honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a firm's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.

Personnel Management

11. A firm's quality control system depends heavily on the proficiency of its personnel. In making assignments, the nature and extent of supervision to be provided should be considered. Generally, the more able and experienced the personnel assigned to a particular engagement, the less direct supervision is needed.

12. The quality of a firm's work ultimately depends on the integrity, objectivity, intelligence, competence, experience, and motivation of the personnel who perform, supervise, and review the work. Thus, a firm's personnel management policies and procedures factor into maintaining such quality.

13. *Personnel Management* encompasses hiring, assigning personnel to engagements, professional development, and advancement activities. Accordingly, policies and procedures should be established to provide the firm with reasonable assurance that—

- a. Those hired possess the appropriate characteristics to enable them to perform competently.⁷
- b. Work is assigned to personnel having the degree of technical training and proficiency required in the circumstances.
- c. Personnel participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies.⁸
- d. Personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

Acceptance and Continuance of Clients and Engagements

14. Policies and procedures should be established for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the firm with reasonable assurance that the likelihood of association with a client whose management lacks integrity is minimized. Es-

⁶ See AICPA *Professional Standards*, vol. 1, AU sec. 220.02

⁷ See (proposed) *Statement on Quality Control Standards, The Personnel Management Element of A Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement*.

⁸ Regulatory agencies that have established continuing education requirements include state boards of accountancy and the U.S. General Accounting Office.

establishing such policies and procedures does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to any person or entity but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its client relationships and the professional services it will provide.

15. Such policies and procedures should also provide reasonable assurance that the firm—

- a. Undertakes only those engagements that the firm can reasonably expect to be completed with professional competence.
- b. Appropriately considers the risks associated with providing professional services in the particular circumstances.

16. To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services. Professional standards may provide guidance in deciding whether the understanding should be oral or written.

Engagement Performance

17. Policies and procedures should be established to provide the firm with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the firm's standards of quality.

18. Policies and procedures for *Engagement Performance* encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. **Where applicable, these policies and procedures should also address the concurring partner review requirements applicable to SEC engagements as set forth in membership requirements of the SEC Practice Section of the AICPA.**

19. Policies and procedures should also be established to provide reasonable assurance that personnel refer to authoritative literature or other sources and consult, on a timely basis, with individuals within or outside the firm, if appropriate (for example, when addressing complex, unusual, or unfamiliar issues). Individuals consulted should have appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation depends on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

Monitoring

20. Policies and procedures should be established to provide the firm with reasonable assurance that the policies and procedures established by the firm for each of the other elements of quality control described in paragraphs 7 through 19 are suitably designed and are being effectively applied.⁹ *Monitoring* involves an ongoing consideration and evaluation of the following:

⁹ See SQC Standards No. 3, *Monitoring a CPA Firm's Accounting and Auditing Practice* (AICPA Professional Standards, vol. 2, QC sec. 30).

- a. Relevance and adequacy of the firm's policies and procedures
- b. Appropriateness of the firm's guidance materials and any practice aids
- c. Effectiveness of professional development activities
- d. Compliance with the firm's policies and procedures

Monitoring should include considering the effects of the firm's management philosophy and the environment in which the firm practices and its clients operate.

ADMINISTRATION OF A QUALITY CONTROL SYSTEM

21. To provide reasonable assurance that the firm's quality control system achieves its objectives, appropriate consideration should be given to the assignment of quality control responsibilities within the firm, the means by which quality control policies and procedures are communicated, and the extent to which the policies and procedures and compliance therewith should be documented.

Assignment of Responsibilities

22. Responsibilities for the *design and maintenance* of the various quality control policies and procedures should be assigned to an appropriate individual or individuals in the firm. In making that assignment, consideration should be given to the proficiency of the individuals, the authority to be delegated to them, and the extent of supervision to be provided. However, all of the firm's personnel are responsible for *complying* with the firm's quality control policies and procedures.

Communication

23. A firm should communicate its quality control policies and procedures to its personnel in a manner that provides reasonable assurance that those policies and procedures are understood and complied with. The form and extent of such communications should be sufficiently comprehensive to provide the firm's personnel with an understanding of the quality control policies and procedures applicable to them. In addition, a firm should establish a means of communicating its established quality control policies and procedures, and the changes thereto, to appropriate personnel on a timely basis.

Documentation of Quality Control Policies and Procedures

24. The size, structure, and nature of the practice of the firm should be considered in determining whether documentation of established quality control policies and procedures is required for effective communication and, if so, the extent of such documentation. For example, documentation of established quality control policies and procedures would generally be expected to be more extensive in a large firm than in a small firm and in a multioffice firm than in a single-office firm. Although communication ordinarily is enhanced if it is in writing, the effectiveness of a firm's system of quality control is not necessarily impaired by the absence of documentation of established quality control policies and procedures.

Documentation of Compliance With Quality Control Policies and Procedures

25. A firm should prepare appropriate documentation to demonstrate *compliance* with its policies and procedures for the quality control system discussed herein. The form and content of such documentation is a matter of judgment and depends on a number of factors, such as the size of a firm, the number of offices, the degree of authority allowed its personnel and its offices, the nature and complexity of the firm's practice, its organization, and appropriate cost-benefit considerations. Documentation should be retained for a period of time sufficient to enable those performing monitoring procedures and a peer review to evaluate the extent of the firm's compliance with its policies and procedures.

EFFECTIVE DATE

26. The provisions of this Statement are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997. **The amendment to paragraph 18 promulgated by the proposed Statement on Quality Control Standards, is applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2000.**